Department of Energy
Power Marketing Liaison Office
Washington, DC 20585

February 22, 2008

Scott Sitzer, Director
Office of Coal, Nuclear, Electric, and Alternate Fuels
Energy Information Administration
U.S. Department of Energy
1000 Independence Avenue, S.W.
Washington, DC 20585

Re: Pre-publication Review of Chapter 4 of the Energy Information Administration's Draft Report, *Federal Interventions and Subsidies in Energy Markets 2007*

Dear Mr. Sitzer:

We appreciate the opportunity to comment on the draft report's policy issues and to suggest technical corrections to improve the accuracy and balance of the final report.

The comments in this letter incorporate the views of the Southeastern Power Administration, Southwestern Power Administration, and Western Area Power Administration, hereafter referred to as the power marketing administrations (PMAs). The comments contained herein address what the PMAs believe are the most important policy issues raised by the draft report. In addition, a detailed set of specific technical/editorial comments is included as a separate enclosure.

Our main concern with the draft report is that the definitions of "subsidy" it uses are not universally accepted. The PMAs do not agree with these definitions. In particular, we strongly believe that charging less than market rates for power is not a "subsidy." The interest rate comparisons and return on equity analyses are also not appropriate, in our view. We believe the report would be significantly improved if it were limited to an analysis of PMA cost recovery.

POLICY ISSUES

Reasons for Lower PMA Power Rates

In our opinion, the draft report erroneously emphasizes that low interest rates on Federal investments are the primary reason why PMA power rates are relatively low as compared to the power rates of other wholesale power suppliers. However, the PMAs contend more important reasons for their lower power rates are:

1) The PMAs' legal requirement to market power at not-for-profit, cost-based rates. Federal power is primarily produced at older hydroelectric power plants

whose capital costs were significantly less than the capital costs of more recently-built power plants. In addition, these original assets have, in large measure, been repaid. Moreover, hydro power plants have no fuel costs, so their operating costs are lower than plants that use other fuels.

2) The PMAs are not responsible for acquiring generation to meet the load growth of their customers. Other wholesale power suppliers with load growth responsibility have built new generating facilities at costs significantly higher than the original cost to build Federal hydropower facilities, thereby requiring higher power rates even if they, too, were limited solely to recovering costs.

Incidentally, while PMA rates are now generally lower than alternative wholesale suppliers of comparable services, this has not always been the case. When the Federal dams were first built, hydropower was not always the least-cost option.

Interest Rate Comparisons

The draft report uses what we believe to be incorrect methodologies for measuring the degree of support provided to the PMAs by the interest rates assigned to their unpaid investments.

In one analysis, the draft report compares the average interest rate on outstanding PMA debt against the Treasury's current cost of borrowing, and concludes that a "subsidy" exists since the average PMA debt is lower. The PMAs believe this is an invalid measure because it implies that PMA interest rates should vary from year to year. In fact, it is equivalent to a home owner with a fixed mortgage rate being deemed as receiving a "subsidy" if mortgage rates increase in a subsequent year. The PMAs are repaying investments like turbines and transmission towers with multi-year service lives. This argues for a fixed interest rate at the time the investment is placed in service. In the PMAs' view, a better interest rate comparison is between the interest rates assigned to PMA investments placed in service in any given year against the Treasury's cost of borrowing in the same year. This apples-to-apples comparison is a more meaningful measure of whether the PMAs are recovering the Treasury's financing cost.

Another analysis in the draft report compares PMA interest rates against market interest rates. The PMAs believe benchmarking PMA debt against investor-owned (IOU) utility debt issuances is not meaningful. The interest rates of IOU (for-profit organizations) debt instruments against the PMAs (not-for-profit organizations) cannot be compared, with operating risk being a major difference and determinant of debt interest rates. It is more appropriate to compare the PMAs' interest rates to other not-for-profit utilities. Finally, the PMAs have different terms on their debt than other utilities. Comparing the PMAs' interest rates to other utilities' rates implies the same debt terms, which is not accurate.

Repaying Higher Interest-Bearing Investments First

The report indicates that the PMAs have an advantage in paying off higher interest-bearing investments first and suggests this is why PMA debt service costs may be lower than that of other wholesale power suppliers. However, this issue becomes immaterial if the PMAs' unpaid investments are assigned a current Treasury interest rate in the year the investment is placed in service. This approach is used to market PMA power and transmission "at the lowest possible rates to consumers consistent with sound business principles," as mandated by law.

In addition, the draft report fails to recognize the PMAs' inability to refinance their capital investments. The ability of other wholesale power suppliers to restructure debt allows them to reduce debt service costs. Also, IOUs' flexibility to raise funds through the sale of equity and debt gives them more control over their debt structures than the PMAs have. Restructuring and/or refinancing debt are sound and commonly accepted business practices not available to the PMAs.

Treasury's Financing Flexibility

The draft report fails to emphasize that the Treasury has other financing flexibilities that are not available to the PMAs. For example, the Treasury has the option and flexibility to issue callable bonds and use short-term financing at lower rates. The PMAs cannot use either of these tools to lower their interest costs.

Market Rate Analysis

The draft report compares average PMA power rates against wholesale power rates charged by nearby IOUs and concludes that the differences are a measure of Federal support for the PMAs. The PMAs do not find this a meaningful comparison. By the draft report's logic, any utility customer who is paying less than what the market will bear is receiving a "subsidy."

The American public chose through Congress to invest in the multi-purpose (e.g. irrigation, power, flood control, recreation, municipal and industrial water, and navigation) projects whose benefits accrue to more constituents than simply electric power customers. The PMAs are responsible for repaying all the power-related costs of these projects, as well as certain other costs assigned to them by law, such as irrigation aid and some flood control and environmental costs. The report fails to mention that power customers are subsidizing the beneficiaries of these other project purposes in certain instances. In fact, many of the other project costs are not repaid at all.

CONCLUSION

The PMAs provide power to preference customers and set power rates in accordance with their authorizing legislation that requires power to be sold at cost. The PMAs power is relatively low cost for this and the other reasons cited above. Changing the current policies of the PMAs would generally require enactment of new legislation.

We request that EIA address the issues raised and make technical corrections before issuing a final report. In addition, we request that you include this letter as an appendix to your report.

Thank you again for the opportunity to offer this review and comment.

Sincerely yours,

R. Jack Dodd

R. Jack Dodd
Assistant Administrator
Power Marketing Liaison Office
U.S. Department of Energy

ENCLOSURE

TECHNICAL/EDITORIAL COMMENTS

PAGE	LINE/TABLE	COMMENT
49	3-4	The first sentence states that the PMAs have access to capital at subsidized interest rates. This sentence is so generic as to be misleading. First, there are several different interpretations of "subsidized," so it is impossible to know if this is true without knowing how that term is used here. Second, the sentence does not reflect that different interest rates are used by each PMA – and in some cases by each power system within a PMA – based on its individual statutes or regulations. We recommend that the phrase "what some consider" be added after the word "at" and the phrase "in some instances." be added at the end of the sentence.
49	20-26	The second paragraph in the "Federal Power Programs" section should be eliminated. There is no need attempt to summarize the entire history of the PMA programs in a few lines for the purposes of this report. In particular, the PMAs do not agree with the assertion that their genesis was principally motivated by the effort to "electrify large parts of rural America".
49	27	Add "directly" to the end of the sentence "Federal utilities do not service residential or commercial customers." The PMAs serve millions of residential and commercial customers <u>indirectly</u> through the sale of wholesale power to retail utilities. The benefits of Federal power do flow to the end use consumers, however.
50	23	This statement is misleading as it states that only a handful of states receive Federal power. The three smaller PMAs deliver power to 30 states.
50	28-29	Revise the second sentence of the fourth paragraph to read "As required by law, they are not-for-profit and are obligated to first offer their power to statutorily-defined preference customers." Federal power can be sold to non-preference utilities if preference entities do not want it.
50	30	Add "Indian Tribes" to the list of preference customers.
51	3	Insert the words "for the power purpose activity" after "operational results".
52	17	The heading "Access to Low-Cost Generation" does not seem descriptive of what the paragraph discusses.
52	21-25	The two sentences starting at "Essentially, taxpayers (i.e. owners)" should be eliminated. These editorial sentences amount to a value judgment. The PMAs do not agree that

		selling power below whatever the market will bear is a subsidy. These two sentences imply that any electricity consumer paying relatively low rates for electricity is by definition being subsidized by those paying higher rates. The PMAs believe that the relevant issue is the recovery of costs, as our statutes direct. In addition, Congress has explicitly prohibited the Administration from studying the issue of selling PMA power at market rates (Energy and Water Development Appropriations Act of 1993, P.L. 102-377, §505).
53	16-26	We request that the second paragraph under the "Measuring Support" section, as well as Appendix C and all other references to market rate comparisons, be eliminated. The PMAs believe the report requested should provide information about subsidies in the electricity sector, and that providing material analyzing options for using revenues in excess of costs from PMA customers to augment general federal revenues is not applicable.
53	12	Insert a comma after "TVA".
54	30	The statement "However, financial markets perceive otherwise…" is stated as fact without a citation. Please include a citation.
56	1	Delete "and the PMAs" from the discussion of ratings and yields of debt instruments since they are not authorized to obtain funds in this way.
56	8	Insert "is" between "market" and "infallible."
56	32-33	Regarding the statement "…DOE requires them to repay higher cost debt early whenever possible…", the word "requires" should be replaced with "allows". This correction should be made throughout the document.
57	2	Footnote 112 citation should be in superscript.
57	7	"is callable" should be changed to "are callable".
59	29-30	Delete "and appear to have adequate cash reserves" as the PMAs do not carry cash reserves.
61	14-16	The following statement is misleading: "…the PMAs can defer payments of debt during revenue shortfalls up to the point of the maturity of the loan. These deferrals can be as long as 50 years." This statement is misleading as the loans are not due until maturity (up to 50 years). Therefore, if the PMAs do not make payments before maturity, it is not a deferral.
65	8	Please change "Western Power Administration" to "Western Area Power Administration".
66	7	The word "give" should be "given".
66	16	Add Illinois to the list of states that SEPA serves.
67	8	Delete "billion" after the word "equaled".
68	12	Delete "F" in footnote reference.

69	6-7	Change "capital expenses" to "capital expenditures".
69	16	Please include a citation for the "OMB study" reference.
70	3	Change "implemented" to "proposed". This proposal was prohibited by Congress and was therefore never implemented.
70	17	Change "top" to "to".
70	6-17	The figures in the "PMA Borrowing Costs" paragraph do not match the table on page 71.
79	19	Insert the word "the" between "increase" and "level".
223	3-14	The language in the "Description" section is not appropriate for providing a descriptive overview of the PMAs. Instead, it is a summary of efforts to privatize the PMAs. We suggest this language be struck, and replaced with the overview provided in the FY 2009 DOE Budget Highlights document: "The four Power Marketing Administrations (PMAs) sell electricity primarily generated by hydropower projects located at federal dams, contributing to the reliability of the nation's electricity supply and grid. Preference in the sale of power is given to public entities and electric cooperatives. Revenues from the sale of federal power and transmission services are used to repay all related power costs."
223	13	Insert "when specifically authorized by law" after "debt forgiveness".
224	2	Revise the sentence to read "…cooperatives, 25 percent to municipalities, and 2 percent to Government agencies."
224	26-28	The first sentence under Rationale should be struck. The PMAs do not agree that the genesis of their programs is well summarized by a reference to promoting economic development in certain areas of the country. We suggest substituting this statement: "The PMAs calculate and repay interest expenses, and all other expenses, in accordance with their statutes and applicable DOE Orders. These methodologies result in lower interest costs for repaying capital investments than the comparable methods identified in this report."
224	36	The PMAs disagree with the last sentence "Efforts are ongoing to make the PMAs pay for themselves…" and suggest deleting it. The PMAs disagree with the implication that we do not recover our costs, in addition to other costs required by law to be recovered by the PMAs. In addition, it is not clear which "efforts" the report is referring to. The PMAs are not aware of any such efforts.
239	27-28	Revise the last sentence of this paragraph to read "These latter costs, including environmental protection and aid to irrigation costs, have been found…"
239	44	Change "these assets" to "these original asset investments".
242	22	Delete "x" from "wasx".

242	26 & 28	Delete "the" preceding "BPA".
243	Table C2	Some of the "Implied Revenue Loss" and "Revenue Loss per Unit of Electricity Sold" numbers do not tie to the other numbers in the table.
244	Table C3	The "Implied Revenue Loss" column should be renamed "Estimated Revenue Foregone". In that column, "82" should be "81". Similarly, the heading "Revenue Loss per Unit of Electricity Sold" should be renamed "Estimated Revenue Foregone per Unit of Electricity Sold".
247	3-4	Regarding the sentence "As a group the 3 PMAs realized minor profits in 2006…", the PMAs are not allowed to make a profit. Alternative language would be "…PMA revenues were greater than expenses in 2006…".
247	9	This paragraph begins with "Ignore this paragraph." Either delete this sentence or delete the entire paragraph.